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METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY

August 3, 2020

Dear Vice Mayor Shulman and Members of Council:

I am writing in regard to Substitute Bill BL2020-286 (as amended), the Budget Ordinance of the Metropolitan Government of Nashville and Davidson County, Tennessee for Fiscal Year 2021, which requires that, not later than noon on August 15, 2020, the Director of Finance shall provide the Metropolitan Council with an updated estimate of revenues, classified by source, to be received by the Metropolitan Government during FY2021 (the “Estimate”).

Attachment One is the Estimate. It is unchanged from the underlying revenue estimate of the prevailing budget for this fiscal year ending June 30, 2021, and I am providing it now because I do not anticipate any new economic data prior to August 15th that would be cause for change.

Though not required by the referenced Ordinance, for purposes of transparency and perspective, I am also providing:

- A recap of my remarks to the Council at its recent meeting on July 21, 2020. Please recall the start of that meeting was significantly delayed due to technical difficulties in the Council Chamber; So, to be expeditious, I dictated my remarks to a written format that was circulated to Council Members by the Council Office. As a matter of practicality and brevity of this report, I incorporate those remarks by reference. See Attachment Two.

- A narrative highlighting just a few of the important economic trends that the Finance Department has considered in its analysis of revenue during the first two months of FY21. Our analysis is ongoing, of course, as we join other government financial leaders around the globe in developing financial forecasting models to match this unprecedented Covid-19 pandemic era.

  Most governments traditionally do not have the highly dynamic forecasting capabilities of private sector counterparts since their revenues and costs do not change so quickly; However, the challenges of this pandemic era are making clear the need for more capabilities. We are taking steps to implement those with a special emphasis on the local economy, which is often an elusive component of dynamic forecasting for local governments due to a multitude of longstanding obstacles to complete, accurate, and timely measurements.

The narrative was prepared by Finance Administrator Brandon Hess in collaboration with (alphabetically) Deputy Directors Talia Lomax-O'dneal, Kim McDoniel, and Mary Jo Wiggins. See Attachment Three.

It is my hope that this early delivery, transparency, and perspective will avoid an unnecessary contest of the same fiscal matters that were passionately debated and resolved during the FY21 budget process that was completed less than seven weeks ago.

It was only eight months ago, shortly after taking office, that I addressed the Council on a FY20 mid-year corrective action plan to immediately bring about a structurally balanced budget and then take meaningful steps to overcome thinning cash and fund balances, cure a multitude of other longstanding financial difficulties, and set the course for financial stability and sustainability.

Despite the daunting obstacles that later emerged from the March tornado disaster, the May Derecho storms, the Covid-19 pandemic, and social unrest, Metro is on a path to achieve these objectives if it remains steadfast in doing so. The corrective action plan was successful. The FY21 budget improved prospects for cash and fund balances and provided for the community services that the Mayor and Council believed important for this era and voted into law. There are many other signs of a promising financial future, such as financial rating agencies recently declaring Metro bonds to be investment grade.

However, the path to achievement could be imperiled if the economic impact of the Covid-19 pandemic worsens. The consequences could include lower revenues or higher expenses; And while we are not inclined to change those forecasts at this time, the Finance Department will be vigilant in its monitoring efforts and will continue working closely with the Mayor's office on countermeasures to change services and corresponding spending if material threats appear on the horizon. It is noteworthy that higher than budgeted expenses could result from many sources, including longer than expected response periods for the weather damages, Covid-19 pandemic, social unrest, or other events.

Depending on the timing and severity of revenue or expense changes, countermeasures could range from a renewed freeze on hiring and capital improvements to a far-reaching elimination of certain services. Metro has already absorbed enormous spending reductions in the last few years, and opportunities for further reductions are slim without eliminating important services to the community and endangering Metro's ability to attract and retain a talented workforce to provide those services.

As I reported to the Council on July 21, 2020, the better than expected revenue results from the first few months of the Covid-19 pandemic period have been a welcome surprise, but the associated uptick to cash and fund balances could be quickly diminished by a combination of lower revenues and higher expenses later in the year. The uptick is an encouraging boost to those balances now, but those remain low overall. It would be irresponsible to diminish this position until it is evident that the economy is stable, and the cadence of revenues and expenses is reliable.

Sincerely,

Kevin Crumbo

Director of Finance

ATTACHMENT ONE

Estimated Revenues by Source
For Fiscal Year 2021

Revenue Source Or Description	General Fund	Debt Service Fund	School Debt Service Fund	School Funds	Total
GENERAL SERVICES DISTRICT:					
Property Taxes - Current Year	$ 559,254,100	$ 187,989,500	$ 68,119,900	$ 427,523,900	$ 1,242,887,400
Property Taxes - Non Current Year	65,293,000	64,500	27,400	4,084,200	69,469,100
Local Option Sales Tax	122,814,300	1,202,000	49,745,100	178,361,400	352,122,800
Other Taxes, Licenses, and Permits	100,480,600	-	-	17,182,100	117,662,700
Fines, Forfeits, and Penalties	5,619,600	241,000	-	1,200	5,861,800
Other Agencies - Federal Direct	2,211,200	-	-	-	2,211,200
Other Agencies - Federal Through State	2,033,300	-	-	500,000	2,533,300
Other Agencies - Other Pass - Through	7,800,000	-	-	-	7,800,000
Other Agencies - State Direct	72,107,900	4,596,000	-	288,467,800	365,171,700
Other Agencies - Other Governments	42,071,200	-	-	10,000	42,081,200
Commissions and Fees	11,093,000	-	-	-	11,093,000
Charges for Current Services	43,375,900	-	-	2,220,000	45,595,900
Compensation from Property	631,300	-	-	1,640,000	2,271,300
Contributions and Gifts	-	-	-	150,000	150,000
Miscellaneous	915,300	4,843,400	-	30,000	5,788,700
Subtotal	1,035,700,700	198,936,400	117,892,400	920,170,600	2,272,700,100
Operating Transfers In	10,690,200	14,555,600	1,599,600	2,300,000	29,145,400
Non-Operating Transfers In	9,617,100	-	-	-	9,617,100
Subtotal	20,307,300	14,555,600	1,599,600	2,300,000	38,762,500
Total Available for GSD Appropriations	$ 1,056,008,000	$ 213,492,000	$ 119,492,000	$ 922,470,600	$ 2,311,462,600
URBAN SERVICES DISTRICT:					
Property Taxes - Current Year	$ 104,583,400	$ 19,014,800	-	-	$ 123,598,200
Property Taxes - Non Current Year	21,008,200	11,800	-	-	21,020,000
Other Taxes, Licenses, and Permits	11,923,900	215,300	-	-	12,139,200
Other Agencies - State Direct	402,600	-	-	-	402,600
Charges for Current Services	1,458,500	-	-	-	1,458,500
Compensation from Property	100,000	-	-	-	100,000
Operating Transfers In	-	1,742,600	-	-	1,742,600
Total Available for USD Appropriations	$ 139,476,600	$ 20,984,500	-	-	$ 160,461,100

Grand total - All Revenues	**$ 2,471,923,700**

ATTACHMENT TWO

Dictation of the Finance Director Report of Revenue Status to the Metro Council 7-21-2020:

The Council has set a schedule for a revenue update in mid-August when more actual data will be available, but I've been asked to report this evening on the status of what has been learned in the first few weeks of July. There's much work to be done, so please keep in mind my report now may change as more data is received.

Yesterday, I was asked to provide a 5 minute update to the Budget & Finance Committee near the beginning of its meeting. For better or worse, 5 minutes turned into a much longer time addressing the many questions raised by Council members.

Vice Mayor Shulman and I discussed afterward how best to make a much shorter, but meaningful, report this evening since you already have a full agenda. We thought this could be accomplished by me simply reporting the status highlights and then summarizing a few of the major themes of questions that were asked and along with my responses. I'll go as fast as I can now since there's been an unfortunate delay getting this meeting underway.

With all of that in mind, I am delighted to report that, right now, revenue collections for the first full three months of the pandemic period appear much better than the dire forecasts near the beginning of the pandemic in the March timeframe.

The first full three months of the pandemic (April, May, and June) correspond to the last quarter of our fiscal year that ended on June 30th, so from a financial standpoint, it's a convenient measurement period.

I'm sure all of you remember March just as well as I do.

Financial markets tumbled, safer-at-home programs were implemented, and people around the globe became uncertain about the future health of themselves and their loved ones, their workplaces, and of course, their pocketbooks.

As these uncertainties grew, our federal government implemented financial relief programs, like the CARES Act that has been much discussed by this Council, the Payroll Protection Program, and other temporary stimulus measures presuming the pandemic would be intense for a few months and then slowly fade.

Presuming the economy would follow a similar path, this was often referred to as the economic V-curve or the Nike Swoosh curve, generally meaning a sharp decline in economic activity in the spring followed by a steady recovery in the following months.

For the spring and summer, Metro's greatest financial exposure is our activity taxes, such as local option sales taxes and business taxes. Property taxes, which is our largest and most reliable source of revenue, mostly happen during the fall and winter months. For those of you who are observers of the state activity taxes, it's notable that Davidson County's activity taxes can be much more volatile than other parts of the state due to our high concentration of tourism, sports, and entertainment.

In late March and early April, our Finance team conferred with the state, economists at the University of Tennessee that we contract with, and local business leaders. We arrived at a forecast that generally followed the V-curve, and by the numbers, indicated about $200 million less than the activity taxes originally budgeted for April, May & June.

Our actual results for those months are turning out to be about half of that, or $100 million less than originally budgeted. So, for the first part of the V-curve model, this means the sharp decline was not as sharp as expected.

This is marvelous news for the moment, however, it is widely believed that a great deal of the difference is due to the positive impact of the government relief and stimulus programs, some of which are expiring very soon, as well as businesses and individuals spending from their savings, benefiting from rent and debt payment relief from landlords and bankers, and other factors which are temporary vs permanent. My own unscientific observation is noncompliance with public health and safety requirements is likely a contributor to better-than-forecasted results.

Altogether, this means activity taxes generated during first three months of the pandemic may be unsustainable unless relief programs and the other items that I mentioned are extended in some fashion. The best information in my hands right now is extensions are uncertain, and even if they happen, may be less than those already provided.

By nearly every measure, the pandemic seems likely to grow and the economy to slow, at least in the near term. I'm confident all of you follow pandemic and economic trends, so I'll not dwell on those this evening other than to say the decline in the first part of the V-curve may not have been as sharp as the expected, but it seems the next part will be at best the same as I reported to you a few weeks ago during the budget debate – bumpy.

The Mayor and I discussed these early revenue results yesterday, and he said, “it sounds like we are counting runs, but the inning isn’t over.” I think this is a good way to think about it right now.

So those are the status highlights for the moment.

For the Q&A yesterday, it was very impromptu, so for those who attended, bear with me as I try to capture the essence of that impromptu encounter in short order here.

1. Will the report to this Council scheduled for August 15th be written or oral?

   There will be a written report with detailed descriptions of the revenue components, and as requested by the Budget & Finance Committee and the Council overall, I’ll be glad to make a presentation of it and answer questions.

2. Is the revenue forecast likely to be adjusted upward as a result of the good news arriving from the first three months of the pandemic?

   It’s too early to be sure, but if measures and forecasts continue to indicate a bumpy, or a generally downward trend, then it’s unlikely the forecast will be adjusted until conditions change.

3. Will the Administration explore spending reductions relative to the budget if things continue to be bumpy or downward?

   Yes, we are already doing that, and based on what we know by August 15th, I’ll let you know about the opportunities and challenges for reductions at that time.

There were some other questions and requests for information from the Committee members, mostly related to the report timing of budget-to-actual results and cash flow. Finance has been responding to those throughout the day today, and we’ll make sure those are fully addressed.

ATTACHMENT THREE

Highlights of Economic Trends as of July 31, 2020. Prepared by Finance Administrator Brandon Hess in collaboration with (alphabetically) Deputy Directors Talia Lomax-O'dneal, Kim McDoniel, and Mary Jo Wiggins.

Since March, uncertainty – from both a public health and economic perspective – has been the prevailing theme regarding the ongoing COVID-19 pandemic. As health experts have learned more, Nashville - along with the state, the country and the rest of the world - has prioritized a shift from a reactionary response during the onset of the virus, to a proactive, measured approach. This is evidenced by actions undertaken locally, which include: Mayor Cooper's Safer at Home orders, mandatory mask mandates, and capacity restrictions for public spaces.

Measures such as these, the subject of debate nationally, have altered the day-to-day lives of citizens across the country. In charting Metro's financial path to recovery, it's imperative that we consider the effectiveness of these measures in mitigating disease transmission, as well as the subsequent impact on the economy and Metro's own revenue collections. As noted by Federal Reserve Chairman Jerome Powell in his monetary policy update on July 29th, "The path forward for the economy is extraordinarily uncertain and will depend in large part on our success in containing the virus. The fiscal policy actions that have been taken thus far have made a critical difference to families, businesses, and communities across the country. Even so, the current economic downturn is the most severe in our lifetimes."

FY 2020 Projected Revenues

Before addressing the FY 2021 budget, an update on fourth quarter FY 2020 revenues (April, May & June) is noteworthy. Initial revisions to revenue estimates during the early stages of the pandemic sought to address, with very limited data, a quickly evolving, multifaceted economic event. This required an examination of existing forecasting methods for validity given the unique circumstances, an analysis of industries and revenue sources expected to be impacted the most, research on peer cities' approaches, and assumptions related to the timing and impact of social distancing measures. In doing this, and after conferring with the state and economists at the University of Tennessee, our initial projected losses totaled about $200M. This figure is now projected to be about $100M, helped largely by federal stimulus measures and the emergency business arrangements such as mortgage and rent deferrals.

These better than expected results for the fourth quarter of FY 2020 will help us restore our cash and fund balances to the minimum 5% levels sooner, but our goal to stabilize Metro's financial position is far from achieved. Based on fiscal year 2019 data received from the state, the general fund balances for Hamilton, Knox and Shelby counties range from 24% to 58%, and only 13 of the 95 counties in Tennessee have fund balances under 20%, leaving Metro comparatively near the bottom of the state. While better than expected results are certainly welcomed, the path forward is highly uncertain, as worsening economic indicators point to a stalling recovery and the progression of the virus disrupts reopening plans.

Virus Progression

As widely reported, recent data has shown that shelter in place policies, which were largely implemented in March and April, were effective in lowering transmission rates and "flattening the curve" of infection rates. However, this public health benefit was accompanied with considerable negative economic implications. In an effort to restart the economy, many states and cities began to loosen these restrictions. In short order, revised projections nationwide for COVID-related cases, hospitalizations and deaths have trended upward, forcing many cities, including Nashville, to reverse course on reopening plans while also heightening hospital bed capacity concerns as we head into the fall and winter seasons when common colds and other illnesses are prevalent. The surge in cases statewide has resulted in Tennessee being labeled a "red zone" for the virus based on per capita infection rates, with federal officials calling for increased restrictions. This change in the virus' projected progression only serves to increase potential volatility in FY 2021's revenue collections, under the threat of prolonged containment policies.

Economic Outlook

Thus far, the pandemic has shown significant influence on economic activity, with the results being detrimental. The country has officially fallen into recession, with the Bureau of Economic Analysis (BEA) reporting that 2nd quarter GDP plummeted 32.9%, the largest drop on record, and four times greater than during any point of the Great Recession. Consumer spending, which accounts for nearly 70% of GDP, also fell a record 34.6% during the same time period (BEA). This contraction occurred despite historic federal intervention in the form of the $1.76 trillion CARES Act, an estimate reported by the Congressional Budget Office, which has provided critical fiscal stimulus benefits to households and businesses alike.

According to the BEA, one-time stimulus checks and enhanced unemployment insurance created a record 14.7% increase in disposable personal income for households during April, which helped support a rebound in consumer spending in May. This upward trend has shown recent signs of stalling, however, as both personal income and spending decreased in June, with information like real time credit card transactions signaling a plateau in spending (BEA). This slowdown comes just as these unemployment benefits, which – according to The Century Foundation - were pumping an estimated $60B into the economy per month, expired for an estimated 25M people at the end of July.

Also troubling is the Department of Labor recently reported initial joblessness claims have now increased for two consecutive weeks, marking the first time over the last 16 weeks. All told, 52.6M people have filed for unemployment benefits of some kind, with data on permanently lost jobs, totaling 3.7M to this point. This is a strong indication there will be additional permanent losses going forward.

Metro has closely monitored these economic indicators, as well as others, in analyzing the performance of our primary revenue sources since the pandemic's onset. While revenue collections overall did not fall nearly as much as anticipated originally, early data points to this being a function of the unprecedented stimulus measures that were enacted, many of which have already expired. Despite these measures and while Tennessee Department of Revenue reported that the state overall experienced a decline of only 1.3%, Metro's local option sales tax collections for May decreased 27.1% year-over-year. This illuminates Nashville's increased exposure to activity tax loss related to tourism and the leisure and hospitality industry.

Conclusion

In addition to economic uncertainty, it should be noted that FY 2021 revenue projections were based on the commonly-known "V" shaped recovery where the overarching assumption was that the economy would sharply decline for a few months and then steadily improve. With increases in the number of new COVID-19 cases and a return to a modified Phase 2 reopening, that has not proven to be the case. While the decline in revenue in FY 2020 was not as steep as initially projected, the recovery is not on a steady path to improvement.

Further, there are unbudgeted expenditures expected to be incurred in FY 2021 that would necessitate fund balance appropriations and/or reductions in services – potentially including temporarily ceasing certain services not directly supporting public health and safety. Right now, estimates of COVID-19 related expenses exceed $15 million, and there are more expenses to finalize and account for. Should we have another surge in cases without federal support, Metro could be faced with covering unbudgeted expenditures at that or higher levels. Although we are still working to identify the costs, the Sheriff's office has been put in the position of unexpectedly having to absorb the operations previously provided by Core Civic in FY 2021, which may result in significant additional start-up and ongoing operating costs. Finally, because of the recent civil unrest, our property insurance premiums are increasing by over $2 million. All these factors and others on the horizon may result in Metro having to absorb additional unbudgeted expenditures in FY 2021 in the tens of millions of dollars.

In the face of an increasingly pessimistic economic outlook and the other factors outlined above, we are not in a position to revise FY2021 revenue forecasts at this time, but we need to be vigilant in our monitoring and increasing our forecasting capabilities.